

Statement of the Healthcare Distribution Management Association

Presented by Ken Couch, President

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of the House Energy and Commerce Committee

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Introduction

Thank you, Mr. Chairman and members of the subcommittee for inviting me to testify today on behalf of the Healthcare Distribution Management Association (HDMA). My name is Ken Couch, and I am President of the Smith Drug Company, located in Spartanburg, South Carolina with a second distribution center in Paragould, Arkansas. I am a former chairman of HDMA and currently serve on the association's Board of Directors.

HDMA represents the nation's primary, full-service healthcare distributors. These 40 distributor members include large and regional companies, some of which are family-owned. HDMA member distributors work to secure a safe, efficient and reliable healthcare supply chain that is able to provide life-saving health products and services. These distributors are responsible for ensuring that billions of units of medication are safely delivered to tens of thousands of community retail pharmacies, hospitals,

nursing homes, clinics and other provider sites in all 50 states in the safest and most efficient manner possible.

Smith Drug Company is a distributor of pharmaceuticals and other health and sundry products that you find in a community pharmacy. Smith Drug Company distributes products to 14 states and services more than 1,200 pharmacies. Our customers are overwhelmingly community professional pharmacy practitioners that own or work for family-owned businesses. They are the corner drug stores of rural areas, towns, cities, and inner cities of the Southeast.

Most people taking medicines give some thought to the pharmaceutical company that made the product, or to the pharmacy and pharmacist that dispensed that product. But few patients understand how that product moves through the system - starting with manufacturer and ending with the patient.

A typical distribution center will store 24,000 products purchased from 800 manufacturers and distribute to 900 pharmacy customers on a daily basis. On an average day, a single distribution center will ship out 60,000 products per day; industry-wide, we deliver 9 million products to the nation's 142,000 pharmacy settings every day. By providing daily delivery with extremely high service levels and business efficiencies in an intricate supply chain, distributors save the healthcare system \$10.5 billion per year.

Preparing for Medicare Part D Implementation

While distributors are not reimbursed by Medicare and are therefore not directly impacted by the Medicare Prescription Drug Improvement and Modernization

Act of 2003, the impact it has on our pharmacy customers is directly felt by their distributors. That is why last year the distribution industry worked very hard to help prepare the nation's pharmacists for the establishment of the Medicare drug benefit.

It is important to understand that for some distributors, like Smith Drug, community pharmacies may constitute in excess of 80 or 90 percent of their customer base. Their problems are our problems. They are more than just customers, they are partners. I am proud that my company and my industry have proven to be such a reliable partner working together to address the challenges that now confront community pharmacy as a result of the implementation of the Medicare drug benefit.

Our industry sought to help prepare community pharmacists through education and awareness so that they would be more knowledgeable and comfortable in answering the Medicare beneficiary's questions. Distributors provided thousands of pharmacists with a variety of learning and outreach tools. HDMA members, for example, developed and sponsored continuing education programs focusing on the benefit; drafted fact sheets and FAQs; provided calendars with key implementation dates and milestones; sponsored brochures and advertisements reminding beneficiaries that their pharmacists are valuable information resources; and establishing web-based resource centers.

Post Implementation Cash Flow Issues

As could be expected with such a massive undertaking, there were some significant "start-up" problems. It is my sense that many of these problems have been addressed or have decreased significantly. I and HDMA commend all those involved

– CMS, pharmacy, prescription drug plans, states and all the other stakeholders – for working together in an effort to do what is best for the patient.

However, a recurring problem for many of our pharmacy customers has revolved around cash-flow issues. Again, my industry has stepped up. On a case-by-case basis, distributors have worked individually with their pharmacy customers to reach mutually acceptable agreements on payment plans. In some cases, credit may have been extended, in other cases, payment terms have been adjusted. For anti-trust reasons, our trade association has not surveyed the membership as to what they specifically have done in this area. However, I can share what my company has done.

By way of background, Smith Drug submits weekly manufacturer purchase orders for the upcoming, forecasted need of our pharmacy customers. We usually receive that product within a few days but sometimes it can take weeks. Our pharmacy customer places an electronic order daily, usually at the close of business, and we deliver the requested products the next morning. Even though Smith Drug has a better than 99 percent service level, to break even we must have better than 13 inventory turns per year. In other words, we must sell and pay for the value of our warehouse inventory in less than a month. Our margins are razor thin, as evidenced by our industry net profit margin of 0.75 percent.

Of my customer base, approximately 60 percent of them have payment terms that require them to pay us twice a month, about 20 percent pay us weekly, 15 percent daily and the remainder have some variation. This twice a month payment terms needs some explanation. In our industry it is generally called semi-monthly pay

terms. Payment for pharmaceuticals purchased by the pharmacy from the 1st through the 15th of the month are due in full on the 25th. The payment must be “in hand” or electronically transmitted. Products purchased from the 16th through the last day of the month must be paid in full by the 10th of the following month. Therefore, a prescription submitted on the 30th of the month would contain product that must be paid to the pharmacy’s distributor by the 10th of the following month. If the payer just changed his payment position to 30 days, the pharmacy would most likely have missed two pay periods to his distributor.

To ease this burden, our company has been working with our community pharmacy customers by providing payment concessions to help them through these hard times. Most of these are at no interest or with no fees charged. However, there is a cost to Smith Drug. We went to our bank and asked for an extended line of credit to ride us through our customer’s short fall of cash flow. We explained that we needed to prepare for a 15-day setback in cash flow. We were asked how much would that be, and we replied \$100 million dollars.

Conclusion

As the members of this committee know, community pharmacists are an essential component of our nation’s healthcare system. Their viability is important to ensure that all patients are able to not only receive their medicines, but for the counseling and medication therapy management services pharmacists can provide.

As noted, to help our pharmacy customers prepare for Medicare Part D, HDMA distributor members proactively worked to provide educational programs and tools.

The amount of preplanning on pharmacy's part was heroic. I believe that had pharmacists not prepared themselves for this major paradigm shift for their patients, the program would have experienced even more severe problems in the first two weeks. The challenge now is to ensure that community pharmacy will continue to be able to keep their doors open to serve the millions of Americans who depend on them for their prescription medications.

I thank you for your attention and will be glad to answer any questions.